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March 14, 2001 **LETTER 1315**

THE PICTURE: I don't know exactly why, but the most difficult thesis to get across to stockholders, analysts, and stock market students is the thesis that stocks are subject to two primary forces. We call those two forces bull markets and bear markets.

History shows us that there are little bull markets and big bull markets. There are also little bear markets and big bear markets.

History also demonstrates that bull markets follow bear markets and bear markets follow bull markets. This is as certain as that night follows day and that day follows night.

There seems to be little correlation between a given bear market and the bull market that follows. However, there does seem to be a definite connection between a bull market and the bear market that follows.

The relationship runs like this. The bigger, the longer, the more speculative the bull market, the more severe the bear market that follows. This is logical, because the bigger, the longer and the more speculative the bull market, the MORE THERE IS TO CORRECT. It's as simple as that.

The bull market that ended in 1999 was the longest in history. It was the most speculative in history. It gathered the greatest public participation in history. It generated the largest volume of trading in history. And it produced the greatest overvaluation in stocks in history.

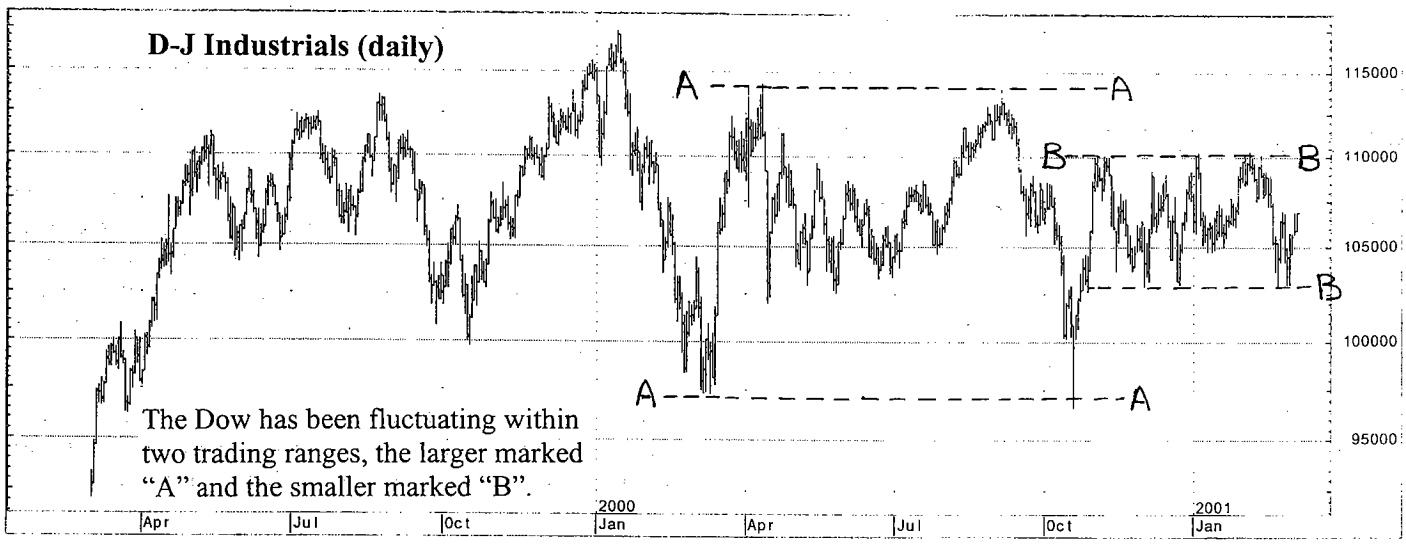
February 23, DJIA 10439.99; PTI 5220; A-D Ratio –4.46
March 2, DJIA 10465.53; PTI 5226; A-D Ratio –3.96
March 9, DJIA 10644.62; PTI 5242; A-D Ratio –3.64
*Dow Times Book Value: +6.50
*Percentage of Undervalued Blue-chips: 7%
*Gold 34-day MA: 272 Dow yield: 1.66; Dow p/e: 21.4

For that reason, I would expect an extended and very severe bear market to follow. But it will take time.

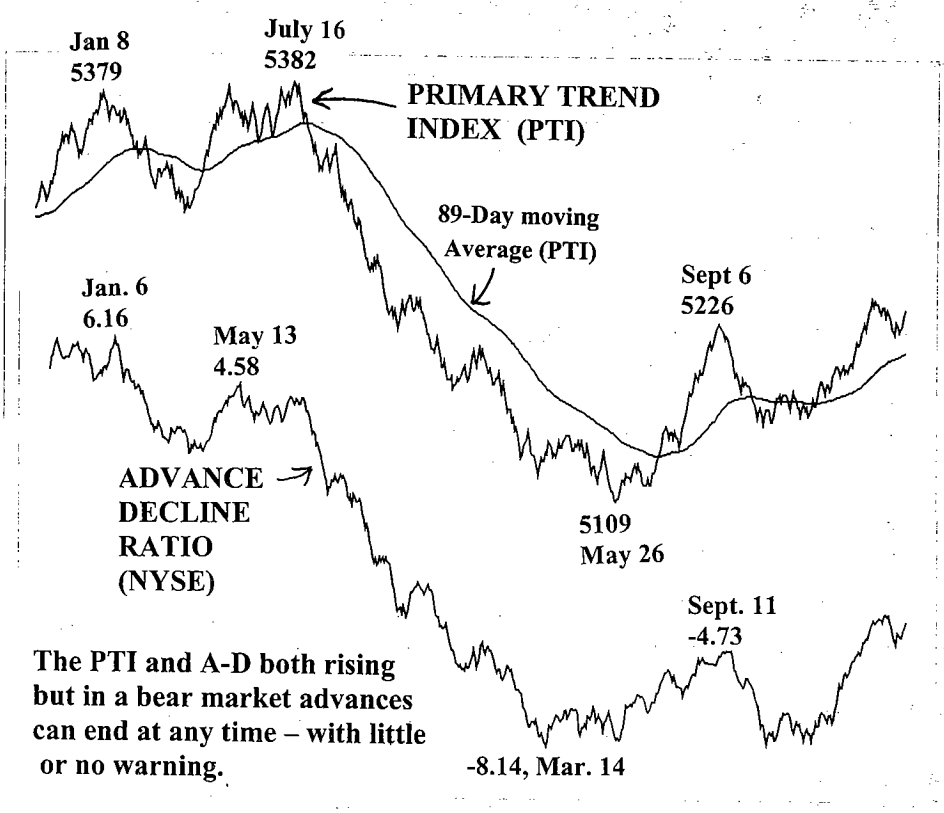
I've said all along that I expect two phenomena to appear. Because people are so bullish, I didn't expect an immediate collapse once the bear market started. For this reason, I said that at least in its early stages this would be a bear market of ATTRITION. In other words, stocks would indeed decline, but the decline would be slow and tortuous. And I believe that is pretty much what has happened (except in the case of the Nasdaq, where the declines have been rapid and in many cases brutal).

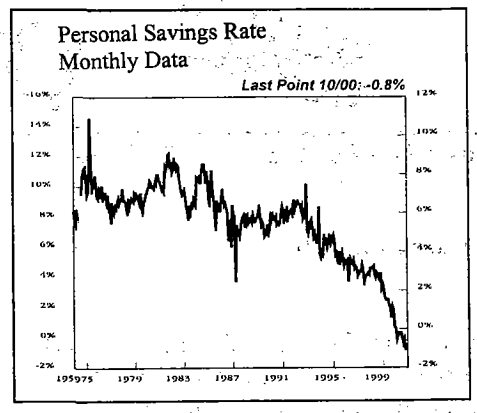
Secondly, I said that the Fed would fight any and all bearish forces "tooth and nail." And that certainly is what happened. Time and time again we've seen the Greenspan Fed come in and "save" the market with rate cuts and huge expansions in monetary reserves. In fact, this was done so often that the expression, "The Greenspan put," has become a familiar, if not ironic, Wall Street term.

To accomplish all these "saves," the Fed has done two things. It has prevented the natural forces of correction from expressing themselves. And two – it has allowed **a huge**



The Dow has been fluctuating within two trading ranges, the larger marked "A" and the smaller marked "B".





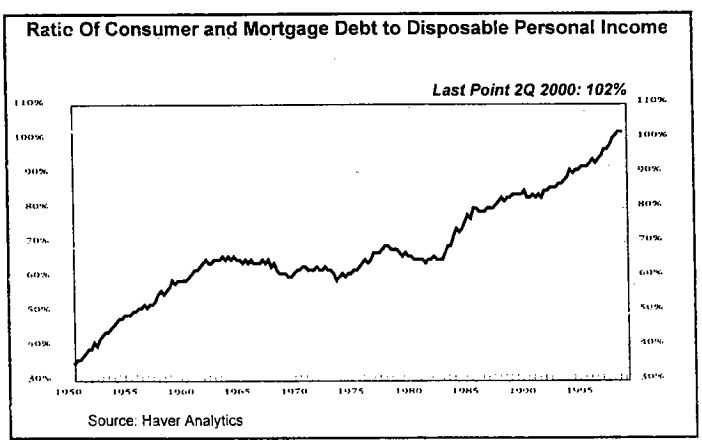
The second chart shows the sad story of US consumers' savings rate. The rates have sunk below zero (chart also courtesy of Gary Shilling).

I should add one thought to all the above. Since 1982, or for an unprecedented period of 19 years, the Dow has never closed below the low of a preceding year. In other words, probably 90% of today's stockholders have never seen a time when the Dow broke below the previous year's low.

speculative edifice to be built. In fact, what we've seen is the greatest speculative edifice in world history.

The foundation of this speculative edifice is DEBT. To build the greatest speculative edifice history has required the greatest creation of debt in history. The debt has been taken on by individuals, by corporations and by states and municipalities and by cities (to say nothing of the Federal government itself).

As an example, this chart, courtesy of A. Gary Shilling's "Insight"' (973-467-4073) show the ratio of consumer and mortgage debt to disposable personal income. You can see that at 102%, consumers have used up all their disposable income. Which is the reason why consumers' savings are negative. They haven't been saving at all – they've simply been spending more than they bring in.



Of course, this is not true of the S&P or the Nasdaq. In February we saw both of these indices break below their low point of the year 2000. This marks the first time since 1982 that the S&P has violated a preceding year's low. Because this is a primary bear market I would expect the Dow to follow in due time (last year's low for the Dow was **9796.03).**

This remarkable fact, 19 years in which the Dow has refused to close below the low of a preceding year, has, I believe, given way to the thesis that stocks are a "buy" on every dip. It follows then that to die rich all you have to do is continue to buy common stocks and presto – by the time you're an old person, you'll also be a rich old person.

This kind of long-term bullishness has been bolstered by the recent and current thesis that Alan Greenspan, the "God of Wall Street," won't allow anything *bad* to happen.

Thus, we've seen "attrition" in this bear market instead of collapse (excluding the Nasdaq, that is). Up until recently, stocks would sink slowly, and all such dips have been bought. It seems to me that it's going to take quite a while for this stubborn, built-in bullishness on the part of US investors to dissipate.

Nevertheless, once US investors turn dead-bearish, and ultimately they will, I believe the stock market will sink to far lower levels than anyone now thinks probable or even possible.

One of my bear market truisms is that **"In a bear market, values deteriorate through time."**

In other words, even though stocks may hold up month after month, as time elapses the value of these stocks deteriorates, and this will ultimately be expressed through panic declines.

We've seen this thesis operate in the sudden collapse of many tech stocks. And we've seen it operate in the crash of the Nasdaq Index.

In the face of the Nasdaq crash, analysts had to come up with another thesis in order to sell stocks. The thesis was VALUE. "Forget tech" is the new cry, "Tech, it turns out, is indeed cyclical. But ah, we should all have followed Warren Buffett, and stuck to value. Warren saw right through the tech mania, that smart fellow. Value, that's where it's at – buy value. You can't go wrong if you stick with value."

Question: Russell, a year ago Wall Street's leading strategists and analysts were competing with each other in predicting new highs for the Dow and the S&P. Almost all of the gurus were bullish. How could so many of them, indeed almost all of them, have been so wrong?

Answer: They were wrong for two reasons. First, they couldn't envision change. They were simply extrapolating current trends into the future.

But more important, these weren't market people, they were economists. And economists deal with what was and then extrapolate what was and prevailing trends into the future. These so-called experts didn't have any real knowledge of markets, and they didn't understand (and still don't) that the stock market leads the economy – **the function of the market is to discount the FUTURE.**

Time after time I included my "Parade of Top-Outs" in these reports as I continued to show that the bull market was dying and that a bear market was being born.

I stated on September 23, 1999, that a primary bear market had been signalled under Dow Theory. I wrote on February 25, 2000, that the bear market had been reconfirmed under Dow Theory.

On May 12, 2000, in a full length interview by Peter DuBois in *Barron's,* I explained why the bull market was dead and why a bear market was starting. In a second interview by Peter DuBois in *Barron's* on December 4, 2000, I outlined the three phases of a bear market and told what I expected would lie ahead (this interview was buried by *Barron's* instead of featuring it as a major piece).

The bear market is still being down-played by Wall Street and the media. It is being down-played partly out of fear, but more probably out of **ignorance.** Today's "experts" don't really understand the meaning of a major bear market which is in the process of following the most speculative bull market in history. Furthermore, they have not done their homework and simply don't know how the stock market works.

I note that analyst after analyst on CNBC is asked about the economy. "What do you think about the economy? Is it still healthy? It looks as though last month was not that bad."

Pathetic. Instead of dealing with what the market is telling us, these pompous fools are dealing with last week's or last month's economic statistics.

One of the things I've tried to teach subscribers is that **IN A BEAR MARKET VALUES DETERIORATE THROUGH TIME.**

The Fed, by fighting the bear, has **extended** the bear market. But even though the bear market has been artificially held back, **values have continued to deteriorate**. Thus, we will see periods where stocks catch up to their deteriorating values. These periods will be expressed via sudden collapses in stocks and averages, collapses which seem inexplicable and mysterious at the time.

I've been asked about the phases of this bear market. It's clear that we're now in the second, and usually the longest phase of the bear market. This is the phase where stocks go down as they discount and reflect deterioration in business and in the economy.

In the second phase the stockholding public will gradually drop their optimism and adopt an increasingly pessimistic view of the stock market. In the second phase we will see a large number of stockholders moving out of the market as their losses mount.

It often pays in investing to "keep it simple." One of the simplest yet most fundamental methods is to monitor the major stock averages in relation to their 200-day moving averages.

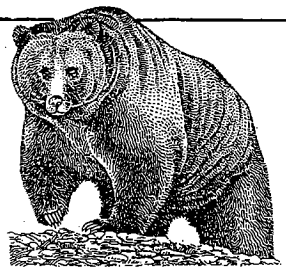
In a primary bull market the major averages tend to hold above their 200-day moving averages. This is true except in cases where severe secondary reactions occur. During severe corrections the major averages may temporarily drop below their 300-day moving averages.

The reverse is true during primary bear markets. In primary bear markets (except during explosive secondary upward corrections) the major averages will tend to hold below their 200-day moving averages.

For reference purposes, the 200-day MA for the Dow is now 10697. The 200-day MA for the S&P is 1372. The 200-day MA for the Nasdaq is 3099. All three of these moving averages are now (bearishly) declining. In the case of the S&P and the Nasdaq, these two averages are so far below their 200-day MAs that you have to marvel that upside corrections have not already started.

In a particularly weak market (and this may be one), instead of an upside correction, when the average gets too far below its 200-day MA, what you may see is an extended period where the 200-MA simply declines towards the average. In that way the oversold condition is worked off without the hoped-for upward correction.

INVESTMENT POSITION: We're moving into the period where you have to make a decision. You will have to decide whether you're interested in serious investing – or well, in thrills.



If you're in stocks now, you're invested in an overvalued bear market that is erratic, possibly close to oversold -- but is suspect because bullishness is still the order of the day.

In a primary bear market stocks embark on a broad move from overvalued to undervalued. The journey may be long or it may be short. In the current situation, everything I see indicates that the journey from overvaluation to undervaluation will be long.

There are two reasons why I believe it will be long. The first is that the bull market topped out at such an incredible extreme of overvaluation.

The second reason is that the Fed is doing everything it can do to hold back the forces of correction (and, of course, that's what a bear market is – a force for correction).

At this time I want to repeat Russell's Bear Market Rule Number 1. "In a bear market everyone loses, but the person who loses the least is the winner."

What's the surest way to be a loser in this bear market? The surest way is to be a stockholder. In fact, you may have already discovered this for yourself.

My advice: be in a money market fund, T-bills, T-notes or high-grade municipal bonds. And be patient, be very patient. This is the time to decide whether you're a thrill-seeker or a serious investor. Because as I see it, this bear market has a long way to go.

I might add that a bear market doesn't have to drop 89% as it did in 1929 to 1932. No, instead, we could face an extended period where the Dow moves basically sideways but there is no dividend income and no capital gains. Just frustration and a loss of income – over a period of years.

If that is to be our fate, we're going to want income. It's not going to come from stocks. But it will come from money market funds, T-bills, T-notes, municipal bonds, taxable bonds.

BACK ON THE "Q": People keep asking or wondering whether this can possibly be a "really big" bear market. One way of gauging the possibilities is via the Q ratio.

The Q ratio was invented by Yale emeritus professor James Tobin, who won the Nobel prize for economics for his work in this area back in 1981.

The Q ratio is fascinating because it has successfully predicted every MAJOR market top of the last century. The Q is not useful most of the time, but it is useful when it measures EXTREMES.

The Q ratio measures two different estimates of the value of US corporations. The first value shows what Wall Street says US corporations are worth; it shows their values simply through market price.

The second value shows their fundamental worth, or what their physical and financial assets are worth.

The ratio of these two valuations is what makes up the Q ratio.

Currently, the Q ratio runs about 150% of replacement values. This is 2 ½ times the average level of the Q ratio over the last century. As a comparison, in the late 1920s and in 1966 and in the early 1970s the ratio was a little better than 120%.

In other words, the Q ratio is higher now than it was at three important market tops.

To get the Q ratio back to real value the stock market could fall as much as 50-60% or the Dow could drop back to the 4000 area.

Dividends on the Dow are now roughly $170. Suppose the Dow was to sell at a yield of 6%, which is where many bear markets have ended. This would take the Dow to below 3000 (and this is assuming no dividend cuts).

Sounds impossible. But this is not far below where the Q ratio says the Dow could go. So Dow 3000 to 4000 would be the area that both a 6% Dow yield and the Q ratio says we could go if this bear market evolves into a major bear market.

The Russell motto – "Hope for the best and be prepared for the worst."

NOTES & QUOTES: According to the In-Charge Institute, the country's largest non-profit provider of credit counseling services, the average household is now burdened with $8,000 in credit card debt. American indebtedness now stands at the highest level since the the late-1980s. The consumer debt level is riding a record high, totaling $1.52 trillion in credit card bills, auto loans, and other types of consumer borrowing as of the end of November, nearly double the amount of a decade ago, according to the Fed.

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You want to know about the US money system and how the commercial banks create money "out of thin air?" Dr. Lawrence M. Parks has written (A Palasade Press White Paper) entitled "The Fight for Honest Monetary Weights and Measures." You can write to FAME, the Foundation for the Advancement of Monetary Education, 211 East 43 Street, NY, NY 10017 for a paper copy or you can pick up the full text on the Internet - www.fame.org. FAME also appreciates any contribution you wish to make.

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The changes in Russia are almost unbelievable. Russia has become, literally, a third world country. Russia is facing an unparalleled "people crisis." The nation's population is collapsing. This from the *Christian Science Monitor* (which, by the way, offers great original reporting): "In the mid-1960s, William Odom was a young American officer assigned to keep tabs on the Soviet troops in Communist East Germany. As he quickly discovered, the Russian army looked healthy and tough. I saw thousands of soldiers, he recalls. They were big, sandpaper-hard, rough, ready peasants.

"When General Odom, now retired, took a more recent first-hand look at Russian Troops, he found something entirely different. They're sallow, sick, poor. I personally observed that decline.

"What has happened to the once-proud Russian army has happened to Russia itself. Russia's population is collapsing. Communicable diseases are spreading. Hospitals are overwhelmed. Birthrates are dropping. Alcohol poisoning is rampant. Sexually transmitted diseases have left millions of women infertile. Environmental problems like heavy-metal pollution have increased birth defects. Joblessness, alcoholism, suicide, and divorce are putting intolerable strains on Russian familes. A typical Russian man now drinks three half-liter bottles of vodka a week, according to a report in the *The Moscow Times*. Abortions, the principal form of birth control in Russia, now outnumber live births by more than 2 to 1. If that weren't enough, the officially reported economy shrank 45% from 1991 to 1999."

The Russian population in 2001 is 146 million. By 2050, according to current projections, the population will be 100 million. Half of Russian males now die before the age of 60. And 30% of Russian women of child-bearing age are now infertile. Odom, who ran America's super-secret National Security Agency in the 1980s, is blunt about what is happening. "Russia is the new member of the third world. From a human point of view, it is just heart-rending."

On the other hand, just the opposite is happening in China. China is turning capitalistic. The old guard is dying off and their children are taking over. The Chinese, unlike the Russians, are hard workers. They are savers, and they know how to make money. Go into any retail store and check to see how many items are made in Russia (usually none) and how many are made in China (just about everything). China now exports more products in dollar value to the US than Japan does. China is on the march, increasing in power just as Russia is on the decline.

The Russian guess is that going forward China will be the US's greatest competitor. It would pay President Bush to take the greatest interest in this nation's relationship with China.

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Everyone loves an optimist - except for stock market technicians. Here's a list of brokerage house recommendations -- an average of 68% say be in stocks and only 23% say be in bonds. And look at those targets for the Dow and the S&P. From a contrary opinion standpoint, this is not a happy listing.

Still No Shortage of Bulls

Here's a look at how major brokerages currently recommend that clients divide their investment portfolios. Shown are each firm's recommended asset weightings for stocks, bonds and cash (money market) or other securities. Also shown are each firm's target prices for the Dow Jones industrial average and the Standard & Poor's 500 at year's end. Each firm believes the market will finish sharply higher this year—which explains the average recommended stock weighting of 68%.

Firm	Stocks	Bonds	Cash/ other	Year-end target: Dow	S&P 500
ABN AMRO	60%	20%	20%	NA	1,425
A.G. Edwards	70	30	0	13,000	1,600
BancAmerica	60	35	5	11,500*	1,525*
Bear Stearns	65	30	5	13,200	1,650
CIBC	55	35	10	12,500	1,625
CS First Boston	90	0	10	12,000	1,520
Deutsche Banc	70	30	0	11,600	1,496
First Union	70	25	5	13,000	1,550
Goldman Sachs	65	27	8	13,000	1,650
J.P Morgan	60	20	20	NA	1,400
Lehman Bros.	80	20	0	12,500	1,600
Merrill Lynch	65	30	5	NA	1,625
Morgan Stanley	80	20	0	12,750	1,600
Prudential	70	5	25	NA	NA
Salomon SB	65	30	5	12,000	1,450
UBS Warburg	64	20	16	NA	1,715
Averages	**68**	**23**	**7**	**12,459**	**1,562**
Current Indexes				**10,466**	**1,234**

* 12-month targets
NA: not available (firm doesn't give a target)

Source: Bloomberg News

Los Angeles Times

Here's some fodder for the bulls. It's about "folksy" stock market barometers. In fashion, when skirts go up the market supposedly goes up. Well skirts are heading for the sky this spring.

Next, as ladies' shoe heels go, so goes the market. Well, spike stiletto heels are in this year. Manolo Blahnik and Jimmy Choo are the high priests of high heels, and these are in, in like Flynn. Is the market listening?

Finally, perfume is supposed to be a good market barometer. Says Roha Dove of Guerlain, "We see more floral fragrances in a recession since they are safe and traditional. In times of boom, we see oriental and other exotic scents." Which is exactly what is happening with the launch of Armani's "Mania" and Lauder's "Intuition." Both are very exotic.

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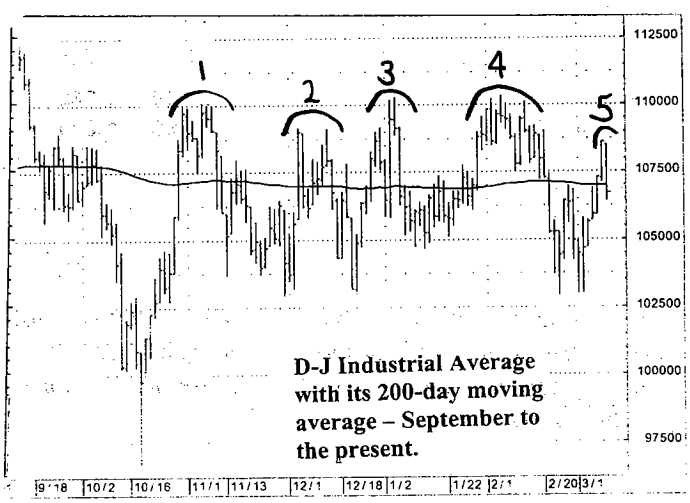
LATE NOTES: After being basically bullish all year, I note a curious passage in the latest issue of S&P's weekly publication, **"The Outlook."** In their statistics, S&P shows their optimistic estimate that earnings for the S&P 500 will be 57.71 this year as against 56.13 last year.

But what's this? On the front page of the most recent "The Outlook" I read, "Our analysts are now estimating a gain of only 3% in operating earnings for the S&P 500 for 2001. And it wouldn't take many more disappointments to push our projection of profits for the 500 into negative territory for the year."

So here's S&P talking about a possible down-year in earnings for the S&P 500. Quite a difference. And how about the Dow? The latest Dow estimates (from *Barron's)* are for Dow earnings to be 606 against 525 last year. My opinion – the Dow too will have a down year in earnings in 2001. And that could be a shocker.

I show below a daily chart of the Dow along with its 200-day moving average. Note that since October the Dow has rallied above its 200-day MA on five separate occasions. Each time the rally has failed and the Dow dropped back below its MA.

The most recent rally above the MA occurred last week, but note that this time the Dow held above the MA for only two days. On Friday (March 9) the Dow dropped back below its 200-day MA again. Not good action.



D-J Industrial Average with its 200-day moving average – September to the present.

I want to stress this point again. In a primary bear market we're not trying to be "cute" or "edgy" or "brilliant." The idea in a bear market is not to make money -- no, the idea in a primary bear market is NOT TO LOSE MONEY. And that's a lot more difficult than you may think.

Remember, we've had many years of a bull market, and in a bull market it's fairly easy to make money. You buy land, you buy a house, you buy commercial property, you buy stocks, you buy the Dow, you BUY and you tend to make money. Face it, you're a genius.

Bear markets don't work that way. You buy and you tend to lose money in a bear market. That's why I say, for my average or typical subscriber the best place to be is in bills or notes or even bonds. In a bear market you're more interested in a return of your capital than you are in making capital gains.

As I write this piece I'm listening to CNBC, and someone is talking about "How you can make money in this market." The answer is that it's a lot easier to lose money in this market than it is to make it. So you've got to reverse your thinking; you've got to accept that the bear is in command, and he's out to take your money as sure as the casinos in Las Vegas are out to take your money.

GOLD: Gold on the move – after all these years? Could be. Here we see a "head-and-shoulders" bottom pattern in the June futures. The breakout would be above 273 on June. If this happens, I get a "count" 15 points higher, which could take June gold to at least 288.

Gold bulls have been disappointed for years, following endless breakouts that have gone nowhere. I always like "head-and-shoulders bottoms" and I have played this one myself with options and futures – and close stops.

What about the gold shares? I've already recommended HM, ASA and NEM. I still like them. Subscribers who bought these earlier as suggested already have decent profits.